



Energy and Climate Change Committee

Oral evidence: [Ofgem Annual Report and Accounts 2014–15](#), HC 543

Tuesday 27 October 2015

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Members present: Mr Angus Brendan MacNeil (Chair), Rushanara Ali, Glyn Davies, James Heapey, Matthew Pennycook, Dr Daniel Poulter, Antoinette Sandbach

Questions 1 - 66

Witness: **Dermot Nolan**, Chief Executive Officer, Ofgem, gave evidence.

Q1 Chair: Good morning.

Dermot Nolan: Good morning, Chair.

Chair: We welcome this morning Dermot Nolan, Chief Executive to Ofgem, to discuss Ofgem's annual report and accounts 2014-2015. Good morning, Mr Nolan. Good to see you again.

Dermot Nolan: Good morning, Chair.

Chair: I will kick off with question 1. Actually, would you like to make an opening statement? Such is my enthusiasm that I was just out of the block straight away.

Dermot Nolan: Such is your enthusiasm. I will be very brief, Chair. I would like to thank the Committee for giving me the opportunity to give evidence about our annual report. Ofgem strives to deliver five key outcomes: lower bills than would otherwise have been the case; reduced environmental damage; improved reliability and safety; better quality of service; and benefits for society as a whole. We published our strategy on that earlier this year and that derives ultimately from our main statutory objective, which is the protection of energy customers in both the short run and, indeed, the long run. We also through our delivery on E-Serve run a number of environmental schemes on behalf of the Government such as the energy company obligation and, indeed, many other schemes. I just wanted to give that very brief introduction. I am very much at the Committee's disposal and I will certainly do my best to answer the questions you have. Thank you.

Q2 Chair: Thank you very much. It has been over a year since you referred the energy market to the CMA, the Competition and Markets Authority, and it will be June 2016 before the CMA publishes its final report. Having seen their provisional findings and possible remedies, what are you doing right now to improve competition in the energy retail market?

Also, what can you do so that when the final report is published action does not have to wait another year or two but is concurrent?

Dermot Nolan: Absolutely, Chair. Two or three points. One slight point is I think it would be the CMA's hope, if I may say, that they would finish in advance of June. June is their statutory deadline. I think they have said that they would hope to finish by April 2016, though they obviously have until June.

Your two points I think based on that are what are we doing in the interim. Well, two things: one, we are co-operating very closely with the CMA subject to the idea of the CMA, of course, being an independent body itself. Thus we have continuous working groups that would regularly meet, CMA working groups that would dialogue with them on some of the remedies, provide whatever information and data they might require from our stores, particularly with regard to issues like code governance, which is a very specific and I think important part of the CMA remedy that perhaps does not get a great deal of attention.

In the meantime, we have done a number of other things to try to promote competition, which is one of our main methods of achieving these particular outcomes that I have set out. In particular, we have published statistics on the state of the market, and one thing we want to do in terms of building what we would see as trust partnership in the market is to bring as much as possible data to light, information for consumers of whatever variety, to allow them to understand what the deal is they are getting and what they can switch. We have, subject to our general tariff guidelines, the retail market review guidelines put in place nearly two years ago, which set the number of tariffs. We have given a number of derogations from those, particularly where companies have come in and asked for new innovative tariffs, tariffs that would, they say, offer better opportunities for vulnerable customers or particular classes of customers or that would bring further innovation into the market. We have approved a large number of those over the last few months, which we believe will foster competition in the market.

We have in general tried to push what we would call our Be an Energy Shopper campaign, which is a campaign we have developed to help people understand their ability to switch, the fact they are empowered to switch, and to bring information throughout the country. We recently went to north Scotland, in fact, Chair, to try to get people to the idea that you can switch, you have rights, it is easy to switch, and it is easy to compare.

We are taking a number of Competition Act cases in the general area of energy. Up to three are currently open. I am afraid I cannot go into great details on them, but we are enforcing the Competition Act. We have co-powers with the CMA to take Competition Act cases in our area. Among other things, we are also looking at bringing competition to areas where there has not been before, generally the monopoly networks, the transmission networks and the distribution networks. One of the Competition Act cases I can say is in the general area of trying to get more competition in the connections market. We are also trying to make the transmission network, certain parts of that, much more open to competition going forward, which we think will bring lower bills. They are just a few things, but I can obviously expand on anything further if you wish.

Q3 Chair: Thank you. You mentioned the CMA being the longer term body there. Where do you see the CMA being distinctive and where do you see the CMA perhaps overlapping with Ofgem?

Dermot Nolan: In the long run, Chair, or in the medium run?

Chair: In the long run.

Dermot Nolan: In the long run, I would say they will have two direct functions relating to Ofgem in the sense that, frankly, they are an appellate body for us. Certain decisions we would make, notably in regard to price controls for transmission and distribution, if someone chose to appeal that decision that would go to the CMA. There are also what we call code modifications and licence modifications that we make. Again, if those are appealed by anyone, the CMA is the appellate body. For instance, recently there was a very substantive appeal of a price control decision, which went to the CMA and they gave judgment on just over a month ago. That would be one aspect.

The other aspect is that if we ever felt that the market or part of the market is, in fact, not working properly, the CMA has extra powers than ours, has the ability to demand a fresh look, and consequently there will always be the possibility of referring some or all aspects of the market to the CMA for a thorough investigation. That will always be there in the long run.

I would envisage two points, I suppose, going forward over the next 12 to 18 months. One is, as I said, we take Competition Act cases ourselves in the energy space. We have a memorandum of understanding with the CMA because they also have Competition Act powers. We have relationships that we can decide relatively amicably, I think, and after carefully being thought through, which body would take respective Competition Act cases in the area.

Finally, if and when the CMA places remedies as a result of its market investigation, I imagine—though this is very much up to the CMA—that we as the regulator may be tasked with administering many of those remedies, checking their efficacy and potentially reporting back to the CMA. I see that as a very probable outcome, though I stress that decision is really for the CMA.

Q4 Chair: Okay. You mentioned switching and I know one of the CMA's proposed remedies is the introduction of the safeguard tariff. What, from an Ofgem point of view, do you feel officially are the difficulties and the challenges that might be associated with the safeguard tariff?

Dermot Nolan: I think there are two or three points. As to whether a safeguard tariff is set is a question for the CMA. We have been considering if we were implementing it a number of possibilities. One would be: who does it affect? I think if the CMA sets a safeguard tariff they would probably provide clarity on that. The draft proposal that came out in their recommendation suggested that pretty much anybody who was on a single variable tariff would have a safeguard tariff, and that is roughly two-thirds to 70% of the

energy households in the country. Deciding who was on the safeguard tariff I think would probably be for the CMA in principle but we might have to administer it specifically and make rules deciding who was affected by it and who was not.

Three other crucial points—because I do think it would be difficult to administer, though obviously we would do it if asked—would be the CMA has said there would be a degree of headroom built into it. My understanding of that is that the safeguard tariff is not set at being the average overall price in the industry. It is being the average plus a margin. In some sense, it would be saying, “We hope you engage in the market, we hope you switch, we hope you will be as active a consumer as possible, but if you do not you are given this level of backstop protection”. I think it would be difficult and perhaps a difficult political choice or a difficult choice for anybody to decide what that margin would be.

Another point would be how the safeguard tariff changes over time in the sense that it is proposed by the CMA in the draft recommendations to be there for roughly five or six years, I think, until the smart meter rollout is complete. One issue would be over that period in time when is it upgraded? When is it changed? Wholesale prices change and, therefore, the probable retail price changes. On the other hand, most consumer evidence suggests that consumers probably do not want electricity or gas prices changing every week. I think there would have to be a mechanism we would have to think through as to when and how it was changed.

The final point I think in terms of administering it would be, as I said, the CMA envisaged it in its draft remedy as disappearing once smart metering was fully rolled out and accepted. Making the decision as to when to remove it I think would be a difficult decision and whether that would lie with the CMA, with elected Governments or with us would be a matter ultimately to be determined.

Q5 Chair: Given the CMA are doing all this, it could be argued that Ofgem has not been providing space to enable free and fair competition, especially fair competition, and the CMA have stepped in and done this and Ofgem has failed in the past. What is your response to that?

Dermot Nolan: My response is that we clearly felt competition was not working well in the market and that is why we referred the market to the CMA. If you are saying—I am not trying to put words in your mouth—does that reflect on us, well, it may well do so to some extent, I would acknowledge that. We sent the market to the CMA for a number of reasons. One is because, frankly, that is the mechanism set out by Parliament. If a market is not functioning as well as possible or as well as a regulator or, indeed, any entity thinks, then the Parliament explicitly provides that the CMA should be the body to take a very detailed look at it. Indeed, there was obviously a reference shortly after the energy market of the personal account banking market for SMEs and residential. I think that is an explicit provision if the market is not working well.

I acknowledge that in some sense as a regulator we had taken steps to try to improve competition and to a large extent it had not worked. We sent the market probably as well for the CMA to evaluate whether, in fact, we had or had not made a good job of it. I entirely accept whatever verdict, if you will, they come out with. If they come out and say

that the regulator did not make as good a decision as it should have, then I obviously will accept that and we will have to learn from it. But we wanted an independent body to look at it, an independent body with expertise in the area.

I would say a final major point as to why we sent it was because the CMA has extra powers than us and, in particular, though it has diminished as an issue, 18 to 24 months ago there was huge public interest in the whole idea of what we tend to call vertical integration. What we mean by that is there was a lot of questioning of the classic model, particularly the model of the large companies, where the big six, as they are sometimes known, companies have their generation arms and their supply arms linked together. There was a lot of belief that this was a problem and this was inhibiting to competition. The CMA has extra powers that we do not have in this regard. It also has experience in looking at these kind of issues in other sectors of the economy. One way or another, we wanted a very clear answer to that. The whole model had been put into question. We wanted someone to take an authoritative look at it and say, “Yes, this model is facilitating of competition” or, “It is not”. They did do that. One of the ironies is perhaps there is far less attention focused on that issue now than there was 12 to 24 months ago, but I think the CMA’s preliminary conclusion said, for good or ill, “We think the model that allows companies to vertically integrate is okay. It is not harming competition” and I am glad they have provided a degree of clarity in that regard.

Q6 Dr Poulter: I accept the points you make about the CMA, but there is a broader issue here. It appears and you have accepted a level of perhaps lack of responsiveness and possibly being slightly asleep at the wheel as a regulator in looking at some of these issues with the energy market, which, as you know, the Committee under the previous Parliament picked up under Tim Yeo. Reflecting yourself on what happened during that period and perhaps some of the issues that you picked up on and I think, quite rightly, some of the concerns you have articulated yourself about that lack of nimblefootedness in responding, quite apart from the CMA process, what are you doing as a regulator to look at how you can put things in a better place in the future when you are overseeing and regulating and looking at the energy market and protecting consumers?

Dermot Nolan: I will come back to that. I may just say one point, if I might. I do not think the regulator was asleep at the wheel. I think it actually was hugely interested in the issue. It is not self-evident to me that it made absolutely the right decision in every case, but it was not asleep. I think from around 2008 onwards—from around 2006-07 really but 2008 was the major change—energy just became a much more important issue in consumers’ lives or certainly in the public eye than it had been. Prices rose significantly. I do not think the industry, the regulator or, in fact, politicians really appreciated what. We tried very hard to try to deal with that. It is not necessarily self-evident it made the right decisions.

Q7 Dr Poulter: Sure, but that is an issue of public perception. But as a regulator, regardless of what the public debate is, regardless of what the political debate is at the time, you as a regulator have a duty to consumers. It should not take that political debate to awaken the regulator. That is what I am getting at. Just reflecting on that period from 2008, as you say, onwards and the fact that it took that heightened political debate and the heightened public

awareness of the energy market and the deals available for consumers to crystallise the need for a review of the market, what have you as a regulator taken and learnt from that to going forward? Because there must be, surely, with regard to the CMA review some things that you have looked at internally and said, “Look, we need to do something better”?

Dermot Nolan: Absolutely. At the risk of sounding glib, we always need to do things better. In terms of some of the things we have learned, one of the things I think we have learned that the CMA is potentially criticising us on is the idea that we have put in place—from 2008 to 2013-14 we put an awful lot of extra rules into the market, very specific rules, the most well known of which is, for instance, a supply company can have no more than four tariffs, as it is called. Our view was, on some of the evidence we had seen from consumers, the sense that they were confused by the sheer profusion of tariffs out there. We put quite restrictive rules. We have a very, very long licence and we had very, very prescriptive rules. Those rules were put in with very much the best of intentions. We thought they would help protect customers against rising prices, and that is very much what we thought at the time, that the best way to protect customers was to have a highly prescriptive set of rules saying what companies can and cannot do. The most obvious of these was saying to a company, “You cannot charge more than four tariffs regardless of who you are, no matter how big a company you are”.

That was something that was done, I think, with the best of intentions. The CMA’s initial conclusions have said, “Frankly, we think that was not the right way to go. We think you have put in too many rules. We think in some sense you are potentially stifling competition in that regard and we want you to relax some of these rules”. We think that although they were put in with the best of intentions the initial CMA view has said, “You need to perhaps move back from that”. The very complex licence, and our licence is very, very long, is potentially acting as a barrier to new entrants, new business models coming into the market who would challenge the established order, and you need to unleash some of the rules on that. That is something I think we have taken on board and are reacting to.

At the same time, and this is one of the key issues in energy, there is always a sense that I think nearly everybody would agree energy is somehow special. It is an essential service. There are certain requirements and standards required of energy that are different from other goods. What we are trying to do, one of the chief lessons we are trying to learn, is to try to adopt a different approach going forward, and we have obviously discussed this with the CMA, of reducing some of the rules and barriers that are in there. Every supplier has a very long licence, but to be slightly less specific about what you can and cannot do and instead rely on a general duty of treating customers fairly. In that sense, we plan to move towards that direction, to shorten the licence, if you like. It is a very long licence. I am probably being repetitive about that at this point, but it is quite long. We want to shorten that, but we want to instil better consumer behaviour by putting a duty, if you will, on a company itself and potentially on the senior management of the company to treat people fairly. I think that is one kind of lesson we have learnt.

If I may say, back in the 2000s there was a view in the regulator perhaps that energy was like any other good, that in the medium run there might not be an energy regulator—and that is a decision for Parliament—but that in a sense it would be like any other good and service and there would be no special protections for energy. I think we learned over the

course of, if you like, the late noughties that was not the case. I would hope we are learning over this current decade that we still need competition to flourish. We still need to put things in place that will allow competition to flourish while at the same time ensure a certain level of protection. We plan to do that by a general duty to treat customers fairly and over the next period of time, and with probably some consultations coming out before this year ends, we really want to give clarity to the industry as to what we expect from you as an industry in terms of how you treat your customers.

Q8 Antoinette Sandbach: Mr Nolan, you referred to the referral to the CMA because you wanted an independent body with expertise in the area to look at the energy market, but aren't you that independent body with the expertise in the area?

Dermot Nolan: We are that independent body with that expertise in the area, absolutely.

Q9 Antoinette Sandbach: You mentioned that the CMA has powers that you do not have. What are those powers that you feel as an energy regulator prevents you looking at fair operation of the market?

Dermot Nolan: Many of those powers are in the area of—well, one would be to set a price control. The CMA's decisions are appealable to a body. There is always another body called the Competition Appeal Tribunal, but it has extra powers that we do not have, which we go through our licence conditions, which themselves are sometimes appealable to the CMA. But this has extra powers to break companies up. It has done so in the past. At the time, one of the single biggest reasons we sent the market was the vertical integration market model where we felt we had no power to intervene. We said the CMA would have extra expertise, having looked at integrated sectors in other areas, that if it felt it was necessary it could make major changes in those areas.

Q10 Antoinette Sandbach: Having seen vertical integration among some energy companies, did you not have the opportunity to refer at the point that that proposed vertical integration was taking place in others?

Dermot Nolan: That certainly was a choice and I think Ofgem looked around 2009 and 2010 at the possibility of referring the market then. As you said, the vertical integration model had grown up slightly before that, but it had grown, if you like, in the noughties. The companies that had been supply companies bought generators and vice versa. Personally, I wish that reference had been made at that time. I think it would have been the right thing to do. Instead, the regulator said, "We will take other measures. We will try to have a very prescriptive approach to supply". In some ways, I wish that decision had not been made and that reference should have been made earlier, but I am afraid that is water under the bridge at this point.

Chair: I am going to move on now and move the session on with Rushanara Ali, one of our new Members, to lead here.

Q11 Rushanara Ali: Mr Nolan, I want to focus on switching and price comparison websites. Can you say a bit about how you think the switching arrangements are working at the moment?

Dermot Nolan: I think the switching arrangements are working better than they have but there are still issues. First, the time of switching takes longer than would be seen as, in my view, optimal. It has shortened. We now have a 17-day switching period, which nearly all companies adhere to. We are absolutely committed to the idea of moving to a one-day switching period over the next few years. We are basically in charge of a large-scale industry project that will ensure that all suppliers—and I mean all suppliers because there is not much point in having just a few suppliers tied into this—will be such that they can switch within one day by 2019. It is a very large-scale industry project. We have done an extensive cost-benefit analysis on it and I do believe it will make switching easier and lower cost.

At the moment, the switching process, levels of switching are roughly running around 11% per year. That is slightly lower than we would like. There is evidence, I think, that people's experience in switching has improved somewhat in the last five or 10 years, but I still think it is less than ideal.

Q12 Rushanara Ali: Where would you have expected it to be?

Dermot Nolan: I do not think there is ever a right level of switching because as people have said to me a few times you could in theory have a low level of switching and have a relatively satisfied market. If companies were generally treating customers well and offering good deals, it is possible that people would stay with them. That can happen so the switching rate by itself is not the only indicator of health in a market, but I would have expected a slightly higher level, probably up around 15%.

Q13 Rushanara Ali: Do you feel that you are doing enough to make customers aware of the benefits of switching, particularly those who would be much better off, would save something in the range of £158 to £234 a year, those on low incomes? If not, what more could you do to try to build awareness?

Dermot Nolan: I think it is hugely important. Whenever I am in a public forum, and this does constitute a public forum, I would encourage people to switch. I would always do that. I would say it is easier now to switch than it has ever been, that there are significant savings to be made, as you said, up to £200 or £300 a year in many cases. I would also say, however, coming back to what I said at the start, our Be an Energy Shopper campaign, which we expend a significant amount of funds in every year, we try to promote in every possibility. It is on our website. It is one of the first things you come to on our website, and we also go around the country and try to promote in potentially local communities the idea of switching and how easy it is to switch. In many ways, I think the one-day switching mechanism will help considerably. I think also the idea of smart meters

will help considerably. Certainly, by 2020 I would really envisage we will be in a situation where people can switch far more easily and have far more control over their energy consumption. However, over that period, in the next few years, I really intend to make sure switching becomes even easier and that people become more aware of it.

Q14 Rushanara Ali: How concerned are you about websites that are deliberately being misleading and the barriers to switching as a result of that and what could be considered anticompetitive behaviour by the bigger energy companies in the disguising of commissions? What are you doing about that?

Dermot Nolan: We are concerned about it for a number of reasons and have done some things, which I will try to talk about. We do not directly regulate, if you like, the switching websites, switching companies. We have no licence powers over them. What we do have is something we call a confidence code whereby if a major switching website wishes to be accredited, it has to have certain criteria. Now, roughly I think about 11 to 12 websites are currently accredited, including most of the larger ones, to be honest. What we did earlier this year—actually put in place I think around the start of this year—is we modified our confidence code. A number of consumers said to us that they felt that some of these websites were not giving them the full story. In particular, we required them to do what is called offer a whole of market view. Thus when you put in your personal details to the website we required a website that was accredited—there are many websites that are not accredited and, as I said, I have no powers over them—to show the full range of deals in the market rather than just a selected range. We think in general that will give more transparency and trust to people using them so they will see the full range.

I will say we have been criticised for that. I do want to make the other point because these decisions are finely balanced. Some have said that was not a good move because you are discouraging innovation and discouraging potentially new kinds of activities by some of the switching websites. Certainly, some of the major switching websites—I will not say whom in this context—have come to us privately and said, “These rules we view as too restrictive. We could give better deals. We could be more innovative for customers in the future if you did not have these restrictions on us”.

Now, given the essential service nature of energy and given the public trust and given the need to build trust in the sector, we did require the whole of market to be shown. But I do think that model will come under further scrutiny and we will need to make important decisions in the next few years. It does seem likely to me, and perhaps I am wrong, that in the next few years more and more consumers will not just buy energy alone. They might buy energy and they might buy telecoms. There is competition potentially coming on water. They may buy all their utilities or even something totally different as a bundled product. How we regulate or how we place conditions in our confidence code on switching sites in that area is going to be a huge challenge. If someone says, “I want to use a switching site for communications and energy and they have different rules” how do we give customers confidence that they can use them adequately? I think that is going to be a huge challenge. I do not know the direct answers, but I think for the moment at any rate we have tried to build as much trust in switching sites as we can by requiring them to show the whole of market view.

Q15 Rushanara Ali: The commissions that are given by some of the sites, is that transparent? Is that clearer?

Dermot Nolan: That is not transparent, no.

Q16 Rushanara Ali: It is not. Is that something you can maybe do more work on to expose where commissions are being paid and those who are not?

Dermot Nolan: There is an overall requirement—my apologies, correct me if I am wrong here. I think there is a requirement in our confidence code that says you must say whether commission is being paid or not, but we do not require the website to specifically reveal how much commission.

Q17 Rushanara Ali: But could you? Is that something worth considering?

Dermot Nolan: We could. I have to say in the analysis we did on this and in our discussions with consumers we did not feel that this was necessary or important for consumers to reveal specific levels of commission. Yes, we could require it if they wanted to be part of our confidence code.

Chair: Thank you. I am going to bring in a number of other Members. There is quite a bit of keenness and interest in this area. Antoinette with a short question, then James, and then Dan and hopefully Glyn, and if colleagues could keep questions short and punchy for the benefit of the—

Q18 Antoinette Sandbach: The confidence code is clearly because there are issues of trust by consumers around switching. We are seeing people like Citizens Advice Bureau, who have launched a new switching site, and local authorities launching energy tariffs. Are there steps that you can take to support, for example, or make people aware of these changes that are happening in the market?

Dermot Nolan: Absolutely. I keep coming back to some extent to Be an Energy Shopper and coming to our website but these are things we try to draw out often at a local level where we can access people better. On the website, for instance, one of the draft CMA recommendations is that Ofgem itself should have a price comparison website. That is a matter for the CMA. If they ask us to do it, we will, of course, do it to the very best of our ability. One particular issue would be I think we will probably need to budget and advertise it to some extent, but we will obviously do it. I personally very much welcome Citizens Advice doing it. I think it is a trusted body. I think it is known outside the energy sector and I am very glad that they are building a particular price comparison website. I view that as positive and we will try to publicise that. Through any of our

communications, we are likely to say, “You can find Citizens Advice in this particular area”.

What that might lead to is a situation where you have a number of commercial websites and then you have Citizens Advice as perhaps the trusted one. The commercial websites might be seen as perhaps more innovative, I do not know, but Citizens Advice might be the website you go to as it is trusted. It seems to me that that is the way the CMA is thinking about it. If you read the report, it said that there should be one almost state website or one particular trusted one. It suggested Ofgem. It could be Ofgem; it could be Citizens Advice. Then it indicated there should be a market for other price comparison websites among the commercial players.

In terms of the community energy things that you see in local authorities, I hugely welcome this. I suppose we have not publicised it to the skies because I am not sure that is our role, but the possible sense that energy itself, not just buying it but energy producing, may become a more local activity is a very possible future, not a definite one but a very possible one. I very much welcome the idea of local authorities perhaps buying from the market itself and directly supplying to them. In that sense, it comes back to what I said earlier and particularly our dealings with some of the community energy groups, where they have said, “It is all very complex. You have made the system very complex and difficult to enter. Can you help us in trying to make the rules simpler and give us knowledge in terms of trying to enter?” We have set up several champions, as we call them, within Ofgem to try to work with smaller entities, including local authorities, to help take them through the rules and they enter the market in a positive way.

Q19 James Heappey: Mr Nolan, does it bother you that the web appears to be the only vehicle for switching? There are areas of the country where connectivity is not good enough. There are areas of the population where neither the skill nor inclination exists to do this sort of thing online. What are your thoughts on any other methods of allowing people to switch?

Dermot Nolan: It does bother me because although I think the web will become even more common in the next five, 10, 20 years, it is certainly not the only way. Doorstep selling is not prohibited. It was limited by all the larger companies around 2008-09 when they—not all but the vast majority of them, if I may say—engaged in misspelling, and then they withdraw their doorstep selling. It is possible for them to do that again and they have the right to do that again provided they in some sense, if I may use the phrase, behave themselves on it.

I do think that for the vast majority of people the web will be common. Vulnerable customers particularly and aged customers are the people who are not necessarily getting access to it. We have tried to deal with that through a variety of ways. We have a campaign. We work with Citizens Advice in order to run a campaign that specifically tries to reach out to more vulnerable customers and offer them specific protections and also offer them advice on switching. That is a campaign we run with Citizens Advice and we will obviously continue that.

I think the biggest challenge, however, for both the CMA and ourselves to come up with is in an environment over the next five years, where maybe in the next 20 years web

connectivity will not be everything to everyone, how do we ensure vulnerable people are protected? The safeguard tariff, frankly, is one method. The safeguard tariff within the CMA was looked at as a general market protection affecting, what, two-thirds of the people. That is clearly not just for vulnerable customers. It could be, and this is entirely a matter for the CMA, that the safeguard tariff is more focused on people who would be perceived as vulnerable and less able to engage in a market. My personal view is that could be a very sensible answer.

Q20 Dr Poulter: What you are saying, effectively, is that those who would benefit the most from switching are the least able to switch?

Dermot Nolan: Not always. I am certainly not saying that myself. I am not trying to be patronising to senior citizens. Many of the ones I meet are actually some of the more active consumers in general. Senior citizens are probably a little bit more web savvy on average. I think that is a problem. Someone needs to work with them in that regard. Vulnerable customers generally need to be protected in some fashion and by and large we do try to protect them. We have various codes of conduct. They are on a priority services register, but by and large it seems to me always that they will need an element of protection. They will also need further advice in how to switch and making them aware of their ability to switch. The definition of vulnerable we use varies over time. We recognise that people's vulnerability changes throughout their lives, but we will always need to give them some level of protection.

Q21 Dr Poulter: What you describe is, I suppose, a divide between the empowered consumer and those consumers who are less empowered. In reaching out to those consumers who are less empowered, due to the fact they are older or for other reasons, maybe on fixed incomes and lower incomes, you have described a number of incentives and ways of reaching out to those groups with the CAB. Are there any mechanisms as a regulator, aside from the tariff that you have described, any other things that you will be looking at that would be able to support reaching out to that group of consumers who are less empowered?

Dermot Nolan: There are quite a number of them. I may follow up, if that is okay, with a letter detailing them, but I will give one specific example here, which is the use of prepayment meters. Prepayment meters have increased in usage somewhat over the last few years. We now have roughly 16% to 17% of the country on prepayment meters. Some of the evidence suggests that the majority of prepayment meters are put in because people are in difficulties. Not all, some people opt for it as a choice and that may be more common in smart meters, maybe like a prepay phone. But the majority are put in for people who are having trouble, and yet we also have evidence that by and large people on prepayment meter tariffs are often paying a little bit more, may have slight difficulties in switching and, as a result, we have taken various steps already and are in the middle of a review to try to ensure people on prepayment meters are much better treated. We are looking at the issues in particular to try to ensure that they do not have to pay an excess cost if a meter is put in on a warrant, that if they want to change back to an ordinary meter

they do not get excessively charged on that. There is a body of work we are doing on that and trying to encourage suppliers to offer more tariffs in prepayment meters.

Q22 Glyn Davies: It is the same area that we have been talking about for the last 10 minutes that I am quite interested in. I think it is probably generally accepted that the lower income households, be it vulnerable or whatever term you want to use, do not switch as much as higher income households. That, in theory, would have the effect of higher incomes—they are switching to pay less, so clearly the profitability of the companies means they will probably recover that money from somewhere else, which probably exacerbates the problem. The one thing I am never sure of is the numbers and the percentages. What kind of percentages of higher income—I know it is difficult to judge this—do switch and what percentage of lower income households switch? I think that could be quite a dramatic difference, which if you have the numbers then it can drive the debate.

Dermot Nolan: It is a very fair question. We do not really have the numbers in the sense we do not have numbers of income. For data protection reasons and for other reasons we cannot know income levels. We do have some indicators on vulnerable customers and people who are classified as vulnerable, their switching levels. On average they are lower. Vulnerability is not a perfect metric for income, but it is fairly close. By and large, we are seeing somewhat lower levels of switching there. If there was a way to do the income thing I would be happy to do so, but given our rules on data protection I do not currently see a way to do it.

Q23 Chair: Thanks for that. Let me just remind the Committee time is moving on and we are not moving on. Can I make a plea for short time-aware questions and time-aware responses as well?

Dermot Nolan: I will do my best.

Chair: It would be welcome. James, you want to move on to smart meters.

Q24 James Heappey: A very quick question first up then: how confident are you that smart meters will be installed in every household by 2020?

Dermot Nolan: I am confident they will be installed. There is a requirement on suppliers that they will have to make all reasonable efforts to be installed. We legally enforce this. Our role is to enforce the licence conditions set by Government that all suppliers have made reasonable efforts. I am confident we will do that. Does that mean that every single household bar one will have a smart meter in 2020? I think that is probably unlikely but we will work and already are working—we will be working, frankly, year in, year out—to make sure suppliers live up to their obligations.

Q25 James Heappey: Your answer focuses very much on some supplier push. It strikes me that equally important is consumer pull and part of that is word of mouth spreading and reporting in the media of the success of smart meters in achieving the maximum benefit for those who have adopted it most early. What are you doing to make sure that those early adopters are getting the maximum benefit that is so critical to driving that pull from consumers going forwards?

Dermot Nolan: Absolutely. There are two points very briefly on that. One is we are trying to bring as much information to light as to what the benefits of smart metering are, as is DECC and the Government. The second point is in some sense the body tasked to give smart meters the demand pull that you have referred to is Smart Energy GB, which is a public body that is tasked with making smart meters in some sense acceptable to customers. They are still in the early stages, but in that regard what they do will be vital. I also think the fact that there are six companies, large companies, a couple of which are moving relatively early, if they move early, if smart meters are seen as being beneficial, it will have a positive knock-on effect on the others. If people have smart meters, see the benefits, it will push others through competition to bring more. That is the way I would see the rollout as occurring.

Q26 James Heappey: I have been impressed by some of the energy companies that are blazing a trail with this and they are monetising the data that comes from the smart meters. Instead of it just being a rather abstract clicking over of kilowatt hours, it is actual cash. Is that something that you might seek to encourage more widely across the industry that you promote that best practice? If the point of smart meters is to manage the market and encourage people to achieve cheaper bills, it seems to me that monetising the usage is the best way to achieve that.

Dermot Nolan: I think that is right and we would certainly push that, but some suppliers, as you said, two in particular—I will not necessarily name them here—have taken further steps than the others and you will see smaller suppliers out there who are basically all smart meters. All they do is give someone a smart meter. Monetising the benefits is very important. One thing we are trying to do at the moment and working with DECC on, though, is spending some time trying to investigate what will happen if and when what we call time of use tariffs become more common, when a large number of people, including potentially disempowered people, have the opportunity for time of use tariffs. Because we do not, I think, fully understand as a society if people are presented with different prices during the day, which strikes me as very sensible, what the overall impact will be. We want to do further work on that with DECC and publish that work and then use that to inform policy going forward.

Q27 James Heappey: Turning briefly to non-domestic consumers, the rollout of advanced meters to commercial consumers was supposed to be finished by April 2014 but you reported in July 2015 that that was well behind schedule. Can you update us on the progress?

Dermot Nolan: Well, progress is now coming to completion. We have taken enforcement action against a number of companies for not meeting that particular obligation. I cannot speak on ongoing cases other than to say it is very likely that we will have some decisions in that area quite soon.

Q28 James Heappey: Are there lessons that can be learnt from the failures in the commercial rollout that can be applied to the domestic rollout?

Dermot Nolan: Yes, I think there are lessons that could be learned in that in some sense the companies initially did not take, if I may say, some of their obligations hugely seriously, did not plan enough in advance, thought they could accomplish the rollout close to the end. Frankly, at least one, maybe two companies, could not do that, did not do it. When we come to the smart metering rollout, when we interact with the suppliers one of the things we are saying to them is, “Do not wait for 2019. That is not the right thing to do. We want you to put in plans year in, year out, and if necessary we will enforce against you at an early point”.

Q29 James Heappey: Finally, Mr Chairman, do you have a big enough stick to make sure that the companies are doing this quickly enough?

Dermot Nolan: I think we do. Our enforcement powers I think are considerable. Enforcement cases take time but we have shortened them. Last year we wrote to all companies saying that any breaches of licences post I think it was May 2014 will see significantly higher fines than previously. I believe we do have sufficient powers. If I felt we did not, I would obviously come back to Parliament and Government and perhaps ask for more.

Q30 Matthew Pennycook: I have a very brief question about alternatives to in-home displays. It seems that so much of the focus and money of Smart Energy GB is in the campaign to roll out in-home displays. Is there a sort of risk, I suppose, that we are focusing too much on a technology that may soon be out of date and there are alternatives, whether it is smart apps on your phone, that might be better suited to at least a section of the market?

Dermot Nolan: It is a very good question but it is one that the decision rests with DECC and I know they are considering the issue. Several industry players, and I have some sympathy with it, have said, yes, for many people in-home displays are the answer and trials that were done show that people tended to respond well to them. But other trials that have been done have suggested that people who perhaps are more tech savvy would just say, “I just want an app on my phone”. Why not give them the option to opt out? Now, DECC is currently studying this quite intensely and are due to make a decision with them. I see the logic of it, I have to say, but they want that to be informed by various trials they are doing. I believe they are due to make a decision in the relatively near future.

Chair: Thank you. Antoinette to lead on the driving down costs to consumers area, a very important part.

Q31 Antoinette Sandbach: You have explained to us in the past that only 44% of the average dual fuel bill is made up of wholesale fuel costs. How has that proportion changed in recent years?

Dermot Nolan: It has fallen over the last 18 months in the sense that the wholesale cost generally moves more quickly. The network cost is generally fairly stable. It has fallen from close to 50% as wholesale costs have fallen over the last 12 to 18 months. One thing I will say and I noted I think in a speech I gave to Energy UK last week is that by and large these wholesale costs, which are predominantly due to the world price of gas falling, have not been passed on in a significant way, I would say, to those on single variable tariffs. In terms of consumer costs, I think you will find that people who are switching, who are on fixed deals, there is quite active competition in the market and people are getting potentially good deals in that regard. However, I am concerned—this is one of the reasons we referred it to the CMA; this is one of the main potential findings of the CMA—that in the single variable tariff these falls in wholesale prices have not really been passed on. There were some movements earlier this year but wholesale prices have stabilised and, indeed, continued to fall and I would look to see some further movements in the coming months.

Q32 Antoinette Sandbach: With wholesale effectively being 44% of it, that means 56% of a consumer's energy bill is down to other costs. Are you concerned about those particular costs rising and, if so, which ones have been concerning you?

Dermot Nolan: I am obviously concerned about them all. Of the remaining 56%, I think networks are roughly 23%. Network costs, we have gone through a series of price controls and, indeed, a very significant appeal over those. Network costs until 2020 are forecasted, and I think accurately forecasted, to be constant in real terms. I think we will have constancy in that regard going forward.

On other issues, I think when I met the Committee in a private session I referred to the 9% costs, which refer to the costs from renewable obligations and energy efficiency. It is difficult to predict how they will occur in the next period of time. It is perhaps more likely that they will rise slightly. That is not something, I must confess, we have control over. That will also depend upon the outcome of the spending review. The reason it is difficult to predict is because some of the mechanisms, and in my view quite sensibly chosen mechanisms, for looking at the amount of money that will go to renewables is what is called a contract for difference. If the wholesale cost looks relatively low, the cost on the bill for renewable subsidy will be high. If the wholesale cost of energy is high, then the cost on the bill for renewable subsidy will be low. That is why it is very difficult to predict precisely what will happen to that 9% in the coming years.

Chair: Thank you. Can we move to the next area of networks and Matthew Pennycook?

Q33 Matthew Pennycook: It has been two years since the RIIO price control framework replaced RPI-X. Just to open up, what do you think the lessons have been from that and, in particular, what the impact has been on consumers since that replacement?

Dermot Nolan: I do think it is still early to give a full view but I will try to give some initial views. It has been two years since the RIIO price controls were done for all the transmission systems and for what we call gas distribution. For electricity distribution, we only finished that particular price control much more recently. They were two years apart. I would say looking at the process I think the process was in my view positive in two ways. First, it encourages—and this was quite explicit in the design—competition between the various network operators to, frankly, be one of the more efficient ones. By and large, the system we use ranks each company against each other, urges them to improve relative efficiency, and I think in that sense it has been reasonably effective at driving efficiency. To be honest, that is probably more effective in distribution than transmission because in distribution, notably electricity distribution, you have a larger number of companies you can compare with each other and gauge their relative performance. That is much harder to do in transmission because you have this enormous transmission company, which is National Grid, and then two relatively small Scottish transmission companies. It is harder to compare relative effective performance with each other. Nonetheless, I think that has been reasonably positive.

A second point would be that throughout the process we would say we got clearer and better business plans from companies as to what they proposed to do over the price control period. They were far from perfect but we feel—and this is based on experience from people who have done Ofgem price controls before, which I must confess I had not—that the companies were much clearer about what they planned to do, what outputs they planned to deliver over a period of time and, by and large, how they planned to communicate with consumers.

The third and final point I would say is the thrust of RIIO was, apart from encouraging more competitive efficiency, to try to say to a network company, “You are not just some faceless network company that never interacts with consumers at all. You are not just building a network. You have to engage with consumers better, listen to them on what they want”. We do think that is a little bit better than it was and certainly inasmuch as we measure signs, and we do, of how satisfied consumers are with their network company, there has been some improvement in that over the last two or three years. Whether or not that will be continued or not I do not know, but it is a huge priority for us in the coming years.

Q34 Matthew Pennycook: Following on from that, the previous Committee raised concerns in the report they did into energy networks about companies earning higher returns than expected under the price control settlements. I think you have been on record as if we got to 2021 and those higher than expected returns were realised, something would have gone wrong. I want to get a sense of at what point you think we will have had time enough to judge or enough evidence to judge whether that is working effectively. Is there any scope for a midterm review, I suppose?

Dermot Nolan: Well, actually, there is a midterm review and we will be consulting on a midterm review early in the new year with regard to the transmission companies and gas distribution companies. We will be consulting on the scope of that I think probably in January/February. However, I would say that this was explicitly not envisaged to be a major reopening. This is not envisaged as a situation that says, okay, we are looking at every element of the cost control and reopening it. It was envisaged when RIIIO was set up as a check to see that the companies were basically delivering on the outputs they said they would be. It will not by itself cause the entire price control to be reopened. For good or ill, I think it is hugely important and it is very much the foundation stone, if you like, of network regulation. Once you have done a price control, you evaluate it as quickly as possible and you learn from it in terms of going forward with the next one. Obviously, we will continue and I am sure we will be at the Committee again. I will continue to update the Committee on how returns are going and how we think the process is developing.

Q35 Matthew Pennycook: Thank you. A linked but separate point: I think it was in January of this year that we discussed you were having conversations with DECC about the idea of establishing an independent system operator, if you could update the Committee on your thinking on that point.

Dermot Nolan: We have had such discussions with DECC. Obviously, a new Government came in and we have talked with Ministers about that. In that sense, I think because it is a major policy change the final decision is likely to rest with DECC and with Ministers there as to whether or not they would do that. We have been in discussion with them. I am not quite sure how much I can say other than to say I think Ministers are interested in the issue and it is possible, I believe, that some consultative document may issue in the future, but that really is a matter for Ministers.

Matthew Pennycook: Thank you. I think I will leave it there, Chair.

Chair: Thank you very much. We will move on to section 6, Rushanara, on vulnerable consumers.

Q36 Rushanara Ali: Mr Nolan, can you say a bit about what action is being taken to make sure that disconnections among vulnerable customers for prepayment meters are being reduced? I know that it has gone down significantly over the years but there are still a concerning number, particularly for electricity supplies. What are you doing about that?

Dermot Nolan: The total number of disconnections in electricity for 2014 was I think 190, maybe 192, which for a country of 60 million is not that huge an amount. I think we have taken a lot of action in that regard. The number for gas is even much lower. I am not saying that problem is resolved. We are continuing to make it very difficult to disconnect.

To some extent I am more worried about, which is not to trivialise the issue, the alternative disconnection, which is the installation of a prepayment meter. In other

countries you might see situations where there is not a prepayment meter installed under warrant, but I am concerned that there are thousands of installations under warrant every year. I am genuinely concerned about those and I am concerned about the rising numbers. There is a code of practice surrounding that. By and large, I think companies adhere to it. What I am concerned about is the sense that it is a very difficult sequence of events for a customer. If they are in significant debt problems, then the situation worsens and worsens in the sense that it ultimately leads to a warrant being installed and them having to pay the costs of that. I am seriously concerned about that. We will be consulting on that with a possible view to a change in the near future. I cannot predict what the answer will be because it will be an open consultation, but it does seem to me somewhat wrong that the people who are potentially already in debt difficulties almost by definition then would be faced with the extra costs of a warrant and ultimately a prepayment meter.

I will say a final comment, though, I would make on this is—I say this hopefully without in any sense being patronising to the people concerned—if you are in debt difficulty it is really important to try to talk to your supplier earlier. Suppliers do have obligations and codes of practices to work out payment plans. Thus it must be immensely difficult if you are paying bills and suddenly another bill comes in to have to deal with it, but it is better to talk to the supplier earlier to try to work a payment plan out.

Q37 Rushanara Ali: There clearly have been attempts to do that and yet the facts are worrying that those on prepayment meters are paying some 22% more, according to the CAB research—I do not know if you would agree with that—than those on direct debit deals. What action can you take to redress that? Because it seems completely inconsistent with the goal of trying to support those who are vulnerable customers.

Dermot Nolan: A couple of comments. I am not sure it is 22%. Our sense of the analysis, and we published a fair amount of analysis of this last year, would be that the average difference between a direct debit customer and a prepayment meter is roughly around £70 a year, which is still certainly not a trivial figure. Prepayment meter prices are also on average about the same as what we call standard credit, which was the traditional way of paying your electricity bill, but they are certainly more expensive than the direct debit, I absolutely acknowledge that. We did a long amount of analysis and did come to the conclusion that that cost difference was, if you like, justified, but in terms of the actual costs suppliers face, prepayment technology was slightly more expensive. We have, however, made it very clear to suppliers that that was the absolute maximum they could go in terms of differential and if they charged less than that we would have no problems with it. I would state that again. I am concerned with the increasing numbers of prepayment meters. As I perhaps hinted earlier, we are actively engaged in trying to make the prepayment experience better in two ways: first, by making it easier, I hope, for people to switch and giving extra information on prepayment meters, but also a consultation, which will hopefully, in my view, lead to a decision—and I cannot prejudge it—that will reduce some of the costs and irritations for people in terms of prepayment meters being installed or otherwise.

Q38 Rushanara Ali: But do you not think it is a bit of a chicken and egg situation? Earlier we heard about some of the barriers to switching, particularly for poorer and more vulnerable customers, and you are relying on that. Whether you agree with the 22% or not, there is a problem. Your proposition, I do not think it is cutting through how customers could be supported. I am not clear. I wonder whether there is room for more innovation here in terms of how vulnerable customers can be supported, because they are paying much more, whether it is against your figures or the CAB figures.

Dermot Nolan: They certainly are paying more. One thing—and I know this is unsatisfactory in the short run—in the medium run, the difference between prepayment and other forms of metered technology should elide once smart meters come along, so by 2020, once the smart meter is there, I would not expect to see any differential. I would, if necessary, take enforcement action based on that.

Q39 Rushanara Ali: That is a long way away.

Dermot Nolan: That is a considerable way away.

Q40 Rushanara Ali: Is there any plan to do piloting with those on prepayment meters ahead of others, because smart meters are likely to be helpful? Is there a case for prioritising them versus others?

Dermot Nolan: I think there certainly is a case, and the CMA recommendations noted this. I am not trying to push the issue away and I will come back to the issue of PPMs, but the matter of the rollout is ultimately a decision for DECC. We have certainly talked with DECC about that as a possibility. Two issues have been raised. One is the technical solution for prepayment meters is not as advanced as they had hoped, and in particular with regard to prepayment meters, which has a relative preponderance of occurrence in large apartment blocks. They are still trying to develop technology solutions for such apartment blocks. They are making considerable progress, but they are not quite at that point.

Q41 Rushanara Ali: In fact, it could be that vulnerable customers who are in that category will be the last or have to wait longer than other customers.

Dermot Nolan: I certainly hope it will not be. We have communicated those views to DECC, but from what I hear, the probability that they will be first seems unlikely. The answer that I have been given—and I respect the answer—is that if indeed one pushed smart meters, specifically prepayment meters, in a way that they were not technologically ready for in terms of the technological solution, that would be a real disaster, because then as a prepayment meter, you would be getting something that did not work as well as it should.

Q42 Rushanara Ali: But when exactly do you expect that to happen, the tests to be done to have confidence that the technological solutions are going to be ready, particularly for those sorts of households?

Dermot Nolan: I am not sure. I will write back to you on this, but it is a matter for DECC.

Rushanara Ali: Sure, thank you very much.

Chair: Moving on to rural customers and their issues, Glyn Davies.

Q43 Glyn Davies: I represent a very rural seat and there are extra costs associated with transport, petrol costs, fuel costs, every single retail product has extra transport costs. There is a cost of living issue in rural areas. Rural energy costs are pretty high as well. Is that an area that concerns you? Is it something you recognise or will you take any action on that?

Dermot Nolan: We recognise it, in a sense, and we published last Friday and sent something to the Chair of the Committee about it. When we looked at different prices of energy, electricity and gas throughout the country, we did find variations. By and large, we found the variations occurred for two reasons. The main reason would be what you would call the underlying network cost, where it varies by area, but by and large, for instance, the network costs in the north of Scotland, the amount of network charge—which is, as I said earlier, about 23% of the bill—is higher in rural areas, certainly Northern Scotland, to some extent North Wales. On average, maybe you would get £20 or £30 a year, sometimes up to £40 a year. That is the chief sense of potentially rural customers pay more. It explains most of the difference and I will come back to that.

There is a second point, which is that—and I am using perhaps Wales and Northern Scotland as examples—many of the customers there have remained on their, if you like, incumbent suppliers, thus in the north of Scotland, one particular supplier still has roughly 70% of the market. In North Wales, another supplier—it may be the same one—has a very large fraction of the market. By and large, there is some evidence that margins in those areas are slightly higher for those particular companies. Frankly, there may be reasons for that. Some evidence has suggested that people like to buy energy from a company with, say, “Scotland” in their name. That would not be something I would necessarily wish to do myself, but some of our consumer surveys have supported that idea.

Q44 Chair: Costly patriotism?

Dermot Nolan: Perhaps, but certainly in at least the two areas I have talked about incumbency is very high and there is probably some evidence margins are higher. In that sense, we would need to try to bring this out and encourage these people to try to switch more and remember the rights they have. I talked earlier about the Be an Energy Shopper campaign and trying to bring that to Northern Scotland and reminding people of the rights

they have in terms of switching. There are also one or two specific areas in Scotland about meter type as well, which we are keeping under control.

To come back to the main point, I said the main difference or reason why certain people are paying more in different parts of the country is because of underlying network charges. We produced a paper that said, “This is why the charges are there”. Frankly, they depend upon the size of the company. In North Wales, which I am using as an example, it is interesting, because it has most of North Wales, which is one of the more thinly populated parts of the UK, but it also has the city of Liverpool, which is obviously one of the most densely populated. They combine them together, but the average charge is still relatively high, though lower than say Northern Scotland. Those charges in some sense came out of the process of deregulation and privatisation in the 1980s and 1990s. The companies were set up in that way. Within that particular company area, we are reasonably content that the average charge is cost-reflective. What we have looked at in the paper we published is whether or not there is a case for saying you can just average the entire charge throughout the country, just make it one network charge for everybody. As I think we said in that—and I think in fact to the previous incarnation of the Committee—that really is a policy decision. There will be winners and losers. Our paper looks at the number of people whose bills would rise and our paper looks at the number of people whose bills will fall. I said to the previous committee we would publish this to contribute to the debate and I am happy to debate it both now or in any future meetings with the Committee in more detail, but ultimately, it is a policy decision for Parliament and Government.

Q45 Glyn Davies: It was interesting the Chair made reference to patriotism because of the name. The company in North Wales is Scottish Power.

Dermot Nolan: That is true.

Q46 Glyn Davies: Can we just look at the connection to the gas network in rural areas? Another sore point. How do you see us improving the situation on that?

Dermot Nolan: A couple of things. The connections to off-grid customers, we call them, they are a significant number, probably more in Scotland and Wales relatively than England. There are a few things. We have funded gas extensions to the network to be done for a significant number of cases, so over the remainder of the RIIO price control, which is about another six years, we see about 90,000 people being connected to the gas grid. However, I freely admit that is still a small fraction of the total amount of people off-gas grid. Two points: one is we have done some work on this, and we have said we would—in fact, I said it again to the previous committee—send some work on this to the Secretary of State with some analysis and views as to how any entity might be given extra powers in this regard. That will come in November.

In the short run, we have done some analysis of, in particular, people who are on electric heating, which I can certainly send to the Committee. It has indicated that, yes, many people on electric heating, some are not too bad, those who are on storage and off-peak, the average amount of bills they pay is not that high compared to people on the gas grid,

but people who have peak storage heating are paying significantly more, and often they are in rented accommodation. This is, frankly, a concern. We are trying to do the best we can in terms of suppliers, in terms of making sure these people are looked after on the priority register and also have opportunities to switch. But there is not an obvious panacea, and I am talking maybe about 700,000 people. There is not an obvious panacea, but we will produce further work on that this year.

Q47 Glyn Davies: Flowing from that, the discount is available to people who are on gas and electricity, but clearly it is not gas connections when people living in rural areas cannot benefit from that. Is that something that worries you and something that you can do something about?

Dermot Nolan: It does worry me. I do not want to sound helpless, but I am not sure what I can do about it. I think a remedy of saying there should be no dual fuel discount seems to be a very disproportionate thing to do. One last comment: I do not want to make this situation worse, but one particular issue, which I understand why it is there, but a source of concern is the fact that I have referred to the various charges. For very good social reasons, the energy efficiency and particularly renewable incentives, they only go on the electricity bill; for obvious reasons, they do not go on the gas bill. A person who is relying on electricity for heating as well and is paying that much higher electricity bill gets a disproportionate element of those and that does not quite seem right to me, but we are not necessarily sure how to resolve it, but we will continue to try to discuss that with DECC.

Q48 Glyn Davies: The last point I wanted to ask was about the energy company obligations. I am only saying this because other people have said it to me, that it has failed to deliver in rural areas. It is not my own evidence of that, because I have not looked for it, but that seems to be a pretty general view, that it has failed to deliver in rural areas. How are you addressing that? From the answers you are giving us, it seems to be losing out in quite a different range of ways.

Dermot Nolan: I am not going to necessarily kick for touch on this, but I will say on ECO, we administer ECO, but our only role in ECO formally is to make sure that companies have delivered on what they said they would. In that sense we have an audit role, which we take obviously very seriously, but we have no autonomy, if you like, our ability to say to companies where they should or should not. ECO, in its current form, is due to finish in March 2017, I think, but I do know that there are discussions ongoing, very extensive discussions within DECC about what—if anything, but I assume something—will replace it. My own sense would be that perhaps the rural issue, perhaps companies maybe—and this is a policy matter—could be told to focus on rural areas more in whatever new gestation of ECO appears.

Q49 Chair: On a matter related to rural areas, when it comes to the winter fuel payments for pensioners, it is the same payment for help with energy costs across the United Kingdom. We know there are differences in temperature across the United Kingdom, quite marked differences, but you have told us as well that there are differences in the network costs that

these pensioners have to pay. Do you think there is an argument to be made somewhere—maybe it is not your argument, but it is an argument—to be said that rural fuel payments, on the basis of the energy costs and the transmission costs, should reflect that differential?

Dermot Nolan: I think there would be. We do not have anything to do technically with the winter fuel payments. It is a policy issue. I do think it is reasonable, even though I am not regulated to comment on policy things, if asked. I would like to think about that a little bit further before I came back to you. There clearly would be some logic to it, but the administering of it and whether or not it would be considered the right policy matter to do, I think it is ultimately a matter for Government.

Q50 Chair: A related rural issue, but not for consumers, more for producers of electricity in quite rural areas, of the charging regime and the network costs. These have changed recently.

Dermot Nolan: Yes.

Chair: Is that an admission by Ofgem that the previous costing regime was wrong and we are now moving to something that is fairer?

Dermot Nolan: I think the new regime we have put in place, this is essentially access to the transmission grid for generators—I think that is what the Chair is referring to—we changed the system of access costs in the last few years. That was a decision that took some time and then was subject to appeal by one of the major companies, which we successfully resisted the appeal. What I would say is that it is an admission that things had changed and we needed to change the regime. One of the main reasons we did change the regime was the increasing intermittency. Ten to 15 years ago, we had far less renewable generation and in particular far less wind generation, which has particular characteristics. A lot of that came on, a lot of it particularly came on in Scotland, some solar in the south-west, but that is less transmission connected. On that basis, we felt we did need to change the regime, that if we kept the regime in place that we had had, it would not have been fair. That is the thrust of why we did it. But I think it was a reflection of changing technology. The energy system is changing, frankly, a lot at the moment. It is not just all sort of large power plants, we are seeing much more intermittent renewable generation, we are seeing small-scale generation. As a result, we obviously have to try to keep up with the times with how we charge for access to the grid.

Q51 Chair: Just a short one: you said “given the changes and the changes you have seen due to external factors of generation”. Do you see this change continuing? Will it change further in the future?

Dermot Nolan: Almost certainly yes, but I am not trying to predict precisely what will occur, but I think there are a number of paths we could go down in Britain in terms of our system. We could have a system whereby in 20 years’ time the number of big power plants, whether nuclear gas or whatever, is much smaller. We could have far less transmission lines, which are the big, big lines going from area to area, and we could have

much more local generation. We could have people with solar panels on their house or small wind generators in their garden and they could have batteries to ensure that they have constant access to the grid; they might never use the transmission line itself. There might be local communities buying and selling energy, or not. That is a very possible future. We are doing work to explore that. Indeed, it could be that things will not have changed that much. I see it very likely there will be change. I am not precisely sure what that change will be, but I know that as a regulator we are going to have to prepare for it and we are going to have to have a reasonably flexible system, that as we see new innovation, new technology, we react to it well and do not spend five or 10 years dithering about it, but ultimately make changes that are necessary.

Q52 Antoinette Sandbach: I read your regional differences and network charges, and in that report you quite clearly indicate that North Wales, Merseyside and in fact Cheshire would benefit by equalisation of network charges, sometimes to the extent of £52 a year—or £52, £36 and £24 a year. It is largely a rural area, with the exception of Liverpool, and the south-west of England also you identify as benefiting a substantial amount. In that report, you talk about targeted support for off-grid customers. Given that unfairness, if you like, in the system has been there for the last two years since RIIO has been in place and your report will not go to the Secretary of State until November, what that means is that cannot feed into the current spending review, so that is a three-year lag in unfairness for off-grid customers or for customers who are substantially disadvantaged. We are talking about switching with sums of £200 or £300 and £56 makes up quite a large proportion of that. How much longer do you see yourself, as the regulator, allowing that position to continue and that inbuilt unfairness to those largely rural areas?

Dermot Nolan: I have to say, I am not trying to necessarily argue this. I am not sure if it is inbuilt unfairness. I think the off-gas grid issue is slightly different and I will come to that, but these costs were determined 20, 25 years ago and they are, within that area, supposed to be cost-reflective. If you took the principle of cost-reflectivity to its end point, then every single person in the country should be charged the exact cost of their connection and it would vary hugely. The cost of a connection in the middle of London would be incredibly small, whereas the cost of connection in the middle of a rural area in North Wales would be relatively low. That is a mad system. Nobody would agree with that, I would have thought, but that would be the idea of cost-reflectivity. That would be the actual logical consequence of that. I think that system would be crazy, but in some sense there is a sort of societal decision: you either say we are all in this together and everybody should face the same cost of the network, regardless of where they live, or you take it to sort of extreme points. There is no right answer in that.

Q53 Antoinette Sandbach: But clearly we are not all in this together in this instance, because most of those people are off-grid, they cannot access the alternative energy choices in terms of gas. The big issue, as you have already identified, is around heating. I think you describe something like 1,600 kW of additional energy, electricity energy use per household, which is a substantial addition to their bills.

Dermot Nolan: Yes.

Antoinette Sandbach: But nothing appears to be being done to address that issue for rural populations.

Dermot Nolan: I think all I can do—and this may be considered unsatisfactory, and I am happy to dialogue with you about it, either here or indeed afterwards, if you wish—is within those who have electric heating particularly to try to work with suppliers to ensure that, subject to the technology they have, they are, as we see it, as fairly treated as possible. It is likely those costs will continue to be higher than the cost of gas, unless gas rises. I am not trying to sound helpless, but I am not sure what precisely we can do beyond that. We can encourage them to be hopefully in as competitive a framework as possible, we can try to make suppliers treat them well, but I am afraid I cannot halve the cost. I wish I could, but I have no powers to do so.

Chair: Thank you very much. Maybe we will have a solution with the champion of district heating systems, Matthew Pennycook, to lead the next section.

Q54 Matthew Pennycook: Mr Nolan, we have spoken about this before. I have four big district heating schemes in my constituency, inner London, South East London constituency, so I realise this does not perhaps apply to others, but there are huge concerns over whether pricing is fair, whether bills are transparent in this area. It cuts against the consumer choice agenda in the sense that these people are locked into monopolies and there is no sector ombudsman. A couple of questions on this: do you think that the heat trusts, the industry-led initiative, their price guarantee can operate effectively? I am thinking particularly in terms of the problems of benchmarking against gas technology, which is very different from district heating schemes. That would be my first question.

Dermot Nolan: We referred to this before, and if I may, before I answer, I did check two points. I did confirm—which I suppose I already knew—we had no powers in this area at all, plus I do not think the company you mentioned has ever formally called on us to take powers in this regard. We could do some analysis of it, but I suppose in the medium run I think it is a very strange if we see a significant increase in district heating to not have some sort of mechanism of control to allow people to switch, and probably some form of regulatory powers for an entity—perhaps not Ofgem—to do that. That is my personal view. My own guess, and this is only a guess, because these are policy issues in an area where I have no powers, is that Government is considering whether or not these are likely to become more and more common, and if so, then it is more likely that they will introduce some set of regulatory protections.

While I absolutely accept that in the area you are, there is already a very significant presence in your constituency, I am not sure whether Government would move to directly regulate them at this point. Simply as more and more of these schemes come together, I think in the medium run it has to be that people will have to feel protected. Something would have to be done. I am not being very specific on what that should be, because again, it would be a matter for Government. But if in 20 years' time 10% to 15% of British citizens are getting their heat from this—and I take the point of the previous question about electric heating being already an issue—there will have to be some sort of consumer protection in place.

Q55 Matthew Pennycook: That is very useful. I suppose my follow-up would be if you think there is a case—and I realise this is a policy question, so I am just asking for your comment, in a sense—for more effective regulation than there is at present, that for all the good that the industry-led initiatives have done, there are flaws to that and that you cannot see DECC stepping in in the very short term, at least, with effective statutory regulation. What can be done in the interim for consumers? Is this something, for example, going back to the conversation we had earlier, for the CMA to look at as something separately? You can imagine for the thousands of my constituents and others who are covered by this, that gap between statutory regulation sometime in the future and the present situation is deeply unsatisfactory.

Dermot Nolan: I will think about it, but I have to say, it is not self-evident to me what can be done. You see, I do not know formally in the areas you have referred to, and I would be very happy to discuss it, to look at some of the patterns of pricing we see. I do not know for sure that in fact customers are being mistreated in this area. We spoke before and you said there was wild variation in bills within the same area and that clearly would be a cause for concern. I have not seen any evidence of that, but I would obviously be happy to look at it. Beyond that, as I said, I do not want to sound helpless, but I have no formal powers to do anything. I do not even have formal powers to require information from the companies concerned. I would be happy to look at it. The idea of whether the CMA would do a study of these markets, it is very difficult for me to offer a view on that. I think they would tend to feel—I am not speaking for them—that there would have to be a reasonably widespread set of markets before they would commit major resources to it, but I am just hazarding a view in that regard.

Chair: Thanks very much. We will move on to fines and penalties, and who better to lead off than Dr Dan Poulter?

Q56 Dr Poulter: Thank you. As a regulator, your annual report indicates that you have levied a number of fines and penalties, both from a consumer perspective, but also on energy companies for not meeting their carbon reduction targets, E.ON and Drax probably being in each category. How do you determine the levels of these fines?

Dermot Nolan: A couple of comments. Personally, I do not determine them at all in the sense that I am separate from the process. We have set up a panel of experts, and I say “experts” in the sense there is considerable experience in the area. Formally we have an enforcement panel, which is headed by, I suppose, an eminent QC and has a variety of people with backgrounds in regulatory competition and energy issues. They make the decision; they make a decision on the terms that they work with. They are technically Ofgem employees, but they are fully independent from the board and indeed from myself. They work with the enforcement team who develop the case, provide them with recommendations and analysis and ultimately they make the decision. In setting penalties, they try to get some sort of estimate of the damage done by the kind of behaviour and add a particular punitive aspect to that, so the idea is they try to see how much damage, “Did this hurt consumers? Let us add a punitive element to that”.

Q57 Dr Poulter: You say you look at that punitive element, but one thing I notice is that it is the big six companies time and time again who are being fined, so in the context of their businesses, do you think these fines are sufficient to encourage them to behave better in future or to stop behaving in the way that they are behaving and take more notice of their consumers or meeting their carbon reduction targets?

Dermot Nolan: I hope they are being efficacious. There is the monetary value itself, but there is also obviously the reputational damage, I think, implied by a public fine. I am concerned, I suppose, in the sense of the period of time the companies did not seem to be reacting to it, and consequently the issue we developed, the reference I made earlier to fines being higher in the future, is something that I hope will have an extra deterrent effect going forward. We said that very publicly last year. The behaviour as a result of that, because there is a lag effect, it has to be for behaviour committed after that, so I think the extra fines will probably occur from cases towards the end of this year and next year. To me, I think there is value in increasing that and I hope it is a deterrent effect; I believe it will be a deterrent effect.

There is always scope for further usage. We discussed recently at the board the possibility of looking for a regime that was somewhat akin to the regime occurring in financial services, where there would be, in some sense, an approved persons regime and there would be some ex-ante control by the regulator as to whether someone was in fact appropriate to run a large energy company. We, in the end, at a board level, decided there probably was not opportunity to pursue that at this particular point in time, but we did not rule out the idea of, if and when we see how the increased fines policy works, the idea of coming back to it and potentially asking Government or Parliament for it in the future. But we will have higher-level fines in future. We will be, as I said, looking at companies and the lessons, whether they broke specific rules, but coming back to what I said earlier, did they break the principles of treating their customers fairly? I think we will have potentially higher fines if we do feel customers were not treated fairly but that would be basic principle on which we will do enforcement going forward.

Q58 Dr Poulter: So there is implicit recognition in that that the current system of fines has in no way had any meaningful effect on changing the behaviour of the bigger energy companies in particular?

Dermot Nolan: I think it has had some effect, in the sense, for instance, without sounding ghoulish about it, recently one of the CEOs of the major six companies was defenestrated perhaps would be the term. I think it has had some effect. I do not think it has had as much effect as we would have liked, hence the higher fine policy. We will obviously implement this rigorously and we will evaluate it and come back to you. I do hope it will be more of an effect going forward.

Q59 Chair: Can fines play a role between levelling the playing field between the smaller and the larger companies than the big six?

Dermot Nolan: I think they can, but we have instituted fines on some of the smaller companies in particular. We have fined someone recently—I will not name the company—because it was perceived as inhibiting the switching process. That is something we are looking at at the moment, any company, once it has a customer, who tries to prevent it from going to someone else. We fined a smaller company for that. Smaller companies have said to us, “We want a level playing field. It is harder for us to enter”. Are fines the only way to do that? I do not think so, because we will hold all companies to account. It comes back to what I said earlier about potentially encouraging new business models, encouraging new entry and I think that is the way we will ultimately level the playing field.

Q60 Dr Poulter: One more question on the beneficiaries of the fines. How does the panel determine who benefits from the fines? I know Age UK, for example, benefited from some money in the past. How is that worked out?

Dermot Nolan: I think it has worked reasonably well, in the sense it is a relatively new innovation; only in the last 18 months, basically, have we felt we had the power to not give all the money to the Treasury. We still give generally a portion to the Treasury, but there is considerable autonomy given to the panel to decide where the fines should go. We did a very, very major fine for one of the companies you mentioned earlier and we gave a very large fraction of that money to the NEA, which is obviously a hugely worthwhile organisation. We are developing metrics going forward to try to ensure that is, I suppose, reasonably dispersed and that we are in some sense accountable for ensuring that relevant bodies get a fair share of it. Early days in that, but I personally think the principle of using a significant fraction of fine money to directly benefit consumers rather than going back to general Treasury funds is probably a reasonably good principle going forward.

Chair: Do you want to look at E-Serve business aspect?

Q61 Dr Poulter: Through E-Serve, Ofgem continues to administer and deliver a number of environmental and social schemes on behalf of the Government, for example, the RHI, the renewables obligation, the feed-in tariff. What are the benefits you see to Ofgem delivering many of these environmental schemes?

Dermot Nolan: These were functions given to us by Parliament. Someone had to do them, so we have tried to do them as effectively as possible. There is one advantage to Ofgem specifically doing them, which is that Ofgem as an entity obviously has licensees, all the suppliers are licensees, so we have extra powers in that particular regard, for instance, if a supply company violated its licence conditions, and we have used those in the past. I think with Ofgem, E-Serve is somewhat separate. It has grown enormously in the last few years, mainly because of the renewable heat schemes, where we directly interact with members of the public and process applications for them. It has grown enormously and it runs semi-separately within Ofgem. I think the main benefit is the licence issue. DECC is looking at the idea of the general delivery landscape and it is certainly conceivable that E-Serve could be separated from Ofgem in the future. Again, that is a matter for Government.

Q62 Dr Poulter: Yes. What impact would that have on you in terms of some of your efficiencies or economies of scale as an organisation, or do you see that as a separate arm of the—

Dermot Nolan: I think it is a semi-separate arm. We are integrated in many ways, but E-Serve is set up so that it could be separated, as necessary. I think we would not necessarily have a problem with it. I suppose all I would look for from the Government is clarity in that regard.

Q63 Dr Poulter: What input do you have on the design and operation of the schemes that you oversee?

Dermot Nolan: Only in any advisory role to DECC. For instance, they are looking at what will happen to ECO in future, issues relating to the RO and the design of the RO, for instance, the CfD mechanism we would have inputted our views, but formally we have no role whatsoever, we simply administer it on behalf of DECC.

Q64 Chair: Okay, thank you. The last area that we want to touch on this morning is the new Enterprise Bill, which may bring regulators under the scope of Government business impact targets. What difference is this going to make to you in practice and do you hope it will make you a lighter touch or do you fear it will make you a lighter touch regulator?

Dermot Nolan: It is hard to say. I will obviously do my best to answer it, in the sense that the new Enterprise Bill seems to say that regulation of natural monopolies are exempt, so one reading of that would be it does not touch that particular area at all. The Bill says also, I think, what is described as pro-competitive activities are exempt from the influence of the Bill and we are seeking further clarity on what that will mean in practice. Given that we would say trying to be pro-competitive cuts across all our activities, there would be a case for saying that it will have relatively little effect on us. I do not know, and that is something we will be engaged with both BIS and DECC going forward.

I suppose my potential concern is that in some of the areas we have been discussing, areas relating to vulnerable customers particularly, that work, which is probably not seen by itself as pro-competitive, one of the best ways of protecting vulnerable customers is to encourage them to participate in the competitive process in the market. But there will always be, as I said, some level of protection for people beyond that. I am slightly concerned that if the Enterprise Bill led to a perception—I am sure that is not intended in any fashion—that work to try to protect vulnerable customers had to be diminished, then I would be concerned and it would impact our work. I am not saying we are in that situation, but I am slightly wary that if the thrust is pro-competition, which I am very pro, regulate natural monopolies, do not forget about but maybe be more concerned about the burdens you place on companies to protect vulnerable customers. I am slightly concerned that that could result in a decreased level of protection thereof. As I said, that is, in some

sense, unclear as to how it will develop, but that is some of the stuff we are interacting with BIS on.

Q65 Chair: Do you think it might give opportunity for some in the energy industry to use as a lever against maybe Ofgem's ideas and structures and argue that they were anti-enterprise?

Dermot Nolan: It might. However, I have seen no sign of that so far, and indeed, some of the Bill is very much—

Q66 Chair: The perennial that I hear are those who want to connect into the grid, it certainly is then subject to location and costs, and as we have said earlier, these are changed. Might that sort of company enterprise, whatever, use this as a lever on Ofgem and therefore in some sectors it could be welcomed, the Enterprise Bill?

Dermot Nolan: It could be. In fact, despite my concern about the potential vulnerability, my personal view—hopefully it is consistent with what I said earlier—as a regulator, we have perhaps got into a situation where we have placed an awful lot of conditions on an awful lot of firms for reasons that we thought were good at the time in terms of customer protection, but that in certain cases we have been too intrusive and have put very specific rules and have perhaps caused some delays in terms of new entrants and new innovation. In that sense, I welcome the potential for sweeping away some of the specifics of the licence. I welcome the idea of a Bill that says, “We want you to cut away unnecessary” if I may use the expression, “red tape. We want you to do that and we want to concentrate on being a more effective supplier for your consumers”. In that sense, I think many aspects of the Bill will be welcome, and indeed, I would say we look forward to working with BIS on it. I think that is a general challenge for the regulator going forward. As I said earlier, I think the industry is going to change a lot. If we are not a flexible regulator, then I think we will be in a problem.

Chair: Okay, thank you very much, Mr Nolan. Do any other members want to raise any final points? If not, I will offer you the final word, if you would like some closing remarks.

Dermot Nolan: Just to say that I am very much at the Committee's disposal and that I am always welcome to attend whenever they wish me to do so. Thank you very much for hearing me today.

Chair: Thank you, and thank you for your time.